

MSRB Proposes Disclosure of Payments in Connection with New Issues of Municipal Securities

The Municipal Securities Rulemaking Board (“MSRB”) recently issued a notice seeking comments on a concept proposal that would require underwriters and municipal advisers to publicly disclose on the MSRB’s Electronic Municipal Market Access (“EMMA”) system whether they have made or received certain payments in connection with new issues of municipal securities. Under the proposal, disclosure would be required for any:

- financial incentives received by underwriters or municipal advisers that may influence their recommendations and
- payments made by underwriters or municipal advisers to incentivize third parties, including incentives for third parties to steer business toward the underwriter or advisor.

Background

In recent years, a series of state and federal proceedings have been instituted that involve undisclosed third-party payments in connection with new issues of municipal securities or closely related transactions. The MSRB is concerned that the practices described in such proceedings present significant challenges to the integrity of the municipal market. The MSRB believes that self-interested advice, conflicting interests, or undisclosed payments to third parties are likely to result in municipal securities issues that later experience financial or legal stress or otherwise perform poorly as investments, resulting in significant harm and cost to investors, issuers, and taxpayers. Existing MSRB Rule G-37 and former Rule G-38 (both related to political contributions) were adopted with MSRB’s belief that disclosure obligations would limit undisclosed relationships that could pose potential conflicts of interest or result in potentially improper conduct by dealers or consultants attempting to obtain municipal securities business. Similarly, the MSRB has recently established a requirement for underwriters to make conflict-related disclosures to issuers of municipal securities and proposed a series of rule changes (since

withdrawn, pending SEC rulemaking) relating to the fiduciary obligations and fair practice duties of municipal advisers which would require conflict-related disclosures to municipal entities and obligated persons.

Proposed Third-Party Payment Disclosure

As noted above, the MSRB is considering whether to require dealers and municipal advisers to disclose certain payments and receipts in connection with their municipal securities and advisory activities that could potentially represent conflicts of interest. All proposed disclosures would be made via filings on the EMMA system. Disclosures would be required with respect to payments, credits (such as inter-company credits or values between affiliated parties), quid-pro-quo arrangements, or other valuable consideration, either provided to any other party, including municipal entities and their personnel, or received from any party other than the municipal entity. Such public disclosures could alert investors and other market participants to any possible conflicts of interest of transaction participants, in a manner similar to the public disclosure of certain political contributions already required

by Rule G-37. In addition, such disclosures would provide municipal entities and the general public with information relevant to the selection of non-conflicted underwriters and municipal advisors for their public sector financial undertakings.

Potential Disclosure by Underwriters

Disclosures of payments and receipts by underwriters to municipal entities would be designed to make transparent any potential financial incentives that may have an impact on the substantial and long-term commitments undertaken by municipal entities. Disclosures that could be required to be made by underwriters include the following:

- any financial incentives received by the underwriter from any third party for recommending a municipal securities financing or any closely related transaction to the municipal entity or an obligated person, or for recommending the participation of any third party to undertake a role in connection with such transaction;
- any other financial incentives received by the underwriter from any third party in connection with a new issue transaction; and
- any financial incentives paid by the underwriter to any third party in connection with a new issue transaction, including, but not limited to, financial incentives paid for the purpose of obtaining or retaining any such new issue transaction.

Potential Disclosure by Municipal Advisors

Disclosures of payments and receipts by municipal advisors would be designed to make transparent any potential financial incentives that may have an impact on the advice provided by municipal advisors to municipal entities or obligated persons in connection with their undertaking of the substantial and long-term commitments related to municipal financial products. Disclosures that could be required to be made by municipal advisors include the following:

- any financial incentives received by the municipal advisor from any third party for recommending any municipal financial product or the issuance of municipal securities or any closely related transaction to the municipal entity or an obligated person, or for

recommending the participation of any third party to undertake a role in connection with such advised transaction;

- any other financial incentives received by the municipal advisor from any third party in connection with an advised transaction;
- any financial incentives received by the municipal advisor from any party for a solicitation of a municipal entity or obligated person on behalf of an unaffiliated dealer, municipal advisor, or investment adviser to obtain or retain an engagement in connection with municipal financial products, the issuance of municipal securities, or the provision of investment advisory services, or for any closely related transaction, including any payment made by the party on behalf of which such municipal advisor undertakes the solicitation; and
- any financial incentives paid by the municipal advisor to any third party in connection with an advised transaction or any other engagement to provide advice as a municipal advisor, including, but not limited to, financial incentives paid for the purpose of obtaining or retaining any such advised transaction or engagement.

Request for Comments

The MSRB seeks comments on the potential benefits and burdens of establishing a public conflicts disclosure program, as well as potential alternatives to achieve the purposes discussed below. The text of the concept proposal is available at <http://msrb.org/Rules-and-Interpretations/Regulatory-Notices/2012/2012-03.aspx>. Comments should be submitted no later than July 31, 2012, and may be submitted in paper form or electronically at <http://msrb.org/Rules-and-Interpretations/Regulatory-Notices/2012/2012-03.aspx>.

If you would like to discuss any of the issues discussed in this Client Alert, please contact any attorney in our Investment Management Group or visit us online at chapman.com.

This document has been prepared by Chapman and Cutler LLP attorneys for informational purposes only. It is general in nature and based on authorities that are subject to change. It is not intended as legal advice. Accordingly, readers should consult with, and seek the advice of, their own counsel with respect to any individual situation that involves the material contained in this document, the application of such material to their specific circumstances, or any questions relating to their own affairs that may be raised by such material.

© Chapman and Cutler LLP, 2012. All Rights Reserved.